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In the Supreme Court of the United States

October Term, 1937

United States of America, Petitioner

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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 667

UNITED STATES OF AMERICA, PETITIONER
v.
HARRY A. KAPLAN

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The special findings of fact, conclusions of law, and opinion of the Court of Claims (R. 4–8) are reported at 18 F. Supp. 965.

JURISDICTION

The judgment of the Court of Claims was entered April 26, 1937. (R. 8–9.) A motion for a new trial was filed by the United States on June 24, 1937, and was denied by the Court on October 4, 1937. (R. 9.) The petition for certiorari was filed on January 4, 1938, and was granted February 14,

1938. The jurisdiction of this Court is conferred by Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

The only question presented is whether the taxpayer, who sold certain securities at a profit during his taxable year 1929 and reported the entire profit therefrom in his 1929 income tax return in accordance with the method employed in keeping his books of account, can later recover the tax paid for 1929 by filing a refund claim treating the sale as an installment sale taxable on the installment basis in accordance with the provisions of Section 44 (b) of the Revenue Act of 1928.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved in this case are printed in the Appendix, *infra,* pp. 26–35.

STATEMENT

The pertinent facts contained in the special findings of fact by the Court of Claims (R. 5–6) are as follows:

On March 15, 1930, a joint income tax return of the respondent Harry A. Kaplan and of his wife was filed for the year 1929, indicating a total tax of $2,084.20 which was paid in instalments in 1930 and 1931. For 1929 and all subsequent years the respondent kept his books of account and made his returns on the cash receipts and disbursements basis.

There was included in the gross income reported in the 1929 return an amount of $194,000 which was the difference between a net selling price of $240,000 and a purchase price of $46,000 paid in June, 1928, for shares of stock in "1100 Park Avenue" which the respondent on April 11, 1929, agreed to sell under a contract whereby the purchaser was to pay $25,000 down and $225,000 in monthly instalments of $1,875, beginning October 1, 1929, together with interest, the shares in the meantime to be deposited in escrow. A commission of $10,000 on the transaction paid in 1929 by the respondent made the net selling price $240,000. On December 28, 1929, the respondent agreed to an assignment made September 23, 1929, by the purchaser of his obligations under the contract to the Comas Holding Corporation.

The respondent received from the purchaser or his assignee on the sales contract the sums of $30,625 in 1929, $22,500 in monthly instalments of $1,875 in 1930, and $5,601.51 in the first three months of 1931, and then the agreed payments ceased.

By agreement of August 12, 1931, between the respondent's wife, to whom he had assigned his interest in the contract for a nominal consideration, and the Comas Holding Corporation, the balance of $191,273.49 was to be paid $2,273.49 down and $2,000 monthly, beginning September 1, 1931. In 1931, $6,273.49 was paid to respondent on the re-

vised agreement to the end of October, and then the payments again ceased.

A further agreement was entered into on March 19, 1932, between the respondent's wife and the Samuel Silver Realty Company, Inc., whereby the former agreed to sell the same shares of stock to the latter for $75,000, payable $750 down and the remainder in monthly instalments of $750, beginning April 10, 1932.

The respondent filed a joint income tax return for himself and his wife for 1930 on March 16, 1931, showing no taxable income and no sale of stock in "1100 Park Avenue" or profit or loss thereon. No income tax return was filed by the respondent for either 1931 or 1932.

By a letter dated November 18, 1931, the Internal Revenue Agent in Charge at New York City notified the respondent of his decision, after audit and investigation of the 1929 return, to recommend an overassessment of $2,084.20 for 1929 [1], conceding the respondent's right to compute the tax in the sale here involved on the instalment basis. On February 29, 1932, the Commissioner of Internal Revenue notified the respondent of his disapproval of the Internal Revenue agent's report and stated that no overassessment was disclosed.

On March 12, 1932, the respondent filed a claim for the refund of the entire sum of $2,084.20 paid

[1] The transcript of record erroneously states this date to be 1919.

as income tax for 1929,[2] on the ground that he was lawfully entitled to the sale of stock on the installment basis. The refund claim was rejected on January 23, 1933. On January 23, 1935, the petition in this action was filed. (R. 1.)

Upon the special findings of fact, the court below made a conclusion of law that the respondent was entitled to recover with interest the tax paid for 1929 and entered judgment accordingly. (R. 8–9.)

On February 14, 1938, the petition for writ of certiorari was granted by this Court, and this case was set down for argument immediately after *Pacific National Company* v. *Welch*, 91 F. (2d) 590 (C. C. A. 9th), now pending before this Court, No. 528, present term, on writ of certiorari granted December 6, 1937.

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that Section 44 (b) of the Revenue Act of 1928 governs in determining the amount taxable to the taxpayer for the year involved as profit derived from the sale of certain securities.

2. In holding that the taxpayer erroneously and mistakenly reported in his income tax return for the year of sale the full amount of profit derived from the sale of certain securities.

3. In holding that the method or basis adopted by the taxpayer for reporting his taxable income

[2] The transcript of record erroneously states this date to be 1920.

for the year involved did not clearly reflect his income.

4. In holding that the taxpayer's action in reporting in his income tax return for the year of sale the full amount of profit derived from the sale of certain securities did not constitute a binding election to have his profit taxed on that basis and did not preclude him from later having his profit taxed under the provisions of Section 44 (b) of the Revenue Act of 1928.

5. In its conclusion of law, based upon its special findings of fact, that the taxpayer is entitled to recover the sum of $2,084.20, with interest, as provided by law.

6. In rendering judgment for the taxpayer for the sum of $2,084.20, with interest, and in failing to enter judgment for the United States dismissing the taxpayer's petition.

SUMMARY OF ARGUMENT

The respondent had the privilege, available at his election, of reporting the profit realized from the deferred payment sale of the stock either as a closed transaction in the year of the sale or on the installment basis in the years in which the deferred payments were received. In his return he elected to use the former of the two alternative methods. The method used clearly reflected his income.

The statute contemplates an election. The election is binding and prevents the taxpayer from changing to the instalment basis in a refund claim

in order to have a lesser income for the year of sale of the stock and a refund determined. The application of the principle of election is necessary for an orderly administration of the tax laws. To permit taxpayers to change would involve the serious administrative burden requiring the readjustment of the taxpayer's income for not only the year of sale but also all subsequent years in which deferred payments are made.

ARGUMENT

A TAXPAYER WHO REPORTS THE ENTIRE GAIN FROM A SALE OF PROPERTY AS GROSS INCOME FOR THE YEAR OF SALE CAN NOT LATER, BY CLAIMING A REFUND, HAVE TAXABLE PROFIT THEREFROM FOR THE YEAR OF SALE COMPUTED ON THE INSTALLMENT BASIS UNDER SECTION 44 (b) OF THE REVENUE ACT OF 1928

The "initial payments" within the meaning of Section 44 (b) of the Revenue Act of 1928 received in 1929 under the first contract for the sale of the stock dated April 11, 1929, were $30,625, a sum less than 40 per cent of the net selling price of $240,000. The taxpayer might have returned the profit on the instalment basis, but he elected in the joint return for 1929 filed on March 15, 1930, to return the entire profit of $194,000, the difference between the net selling price of $240,000 and the cost of $46,000, as gross income for 1929 under the method of reporting deferred payment sales, not on the instalment basis, recognized by the statute and Treasury Regulations (Revenue Act of 1928, Section 111 (c), Treasury Regulation 74, Articles 351–355).

A. THE STATUTE PERMITS ALTERNATIVE METHODS, AVAILABLE AT THE ELECTION OF THE TAXPAYER, OF REPORTING GAIN UPON CERTAIN DEFERRED PAYMENT SALES OF PROPERTY

Section 41 of the 1928 Act provides in part that the net income of a taxpayer shall be computed "in accordance with the method of accounting regularly employed in keeping the books of such taxpayer".[3]

"Method of accounting" as used here refers to the general bookkeeping system employed by a taxpayer and does not mean the treatment of individual items of receipt or expenditure. *United States* v. *American Can Co.*, 280 U. S. 412, 419; *Niles Bement Pond Co.* v. *United States*, 281 U. S. 357, 360; *Aluminum Castings Co.* v. *Routzahn*, 282 U. S. 92, 99.

A taxpayer may employ any "method of accounting" appropriate to his needs which clearly reflects income. The "method of accounting"

[3] Prior to the enactment of the Revenue Act of 1916 returns were required to be made upon the basis of actual receipts and disbursements. It was found in the administration of the earlier laws, however, that the income could be more clearly reflected in many cases by the employment of an accrual method. Since 1916 the law has required returns to be made in accordance with the method of accounting employed by the taxpayer in keeping his books unless the method does not clearly reflect the income. *United States* v. *Anderson*, 269 U. S. 422, 438; *Aluminum Castings Co.* v. *Routzahn*, 282 U. S. 92, 96; Section 38 of the Corporation Excise Tax Act of August 5, 1909, c. 6, 36 Stat. 11; Section II, subdivision G (b) of the Income Tax Act of October 3, 1913, c. 16, 38 Stat. 114, 172; Sec. 13 (d) of the Revenue Act of 1916, c. 463, 39 Stat. 756; Sec. 212 (b) of the Revenue Acts of 1918, 1921, 1924, 1926; Sec. 41 of the Revenue Acts of 1928, 1932, 1934, and 1936.

ordinarily is the cash receipts and disbursements method employed by this respondent, or an accrual method.

No default of payments under the contract occurred until after March of 1931, two years after the sale was made and a year after the return was filed (R. 5). The respondent did not seek to change to the instalment basis until after a default on the contract.

The respondent contended that he erroneously and mistakenly reported a 1929 profit of $194,000 on the sale of the stock in that he kept his books of account and filed his returns on the cash receipts and disbursements basis and the $194,000 did not correctly reflect his taxable income from the sale of 1929 (R. 2). The court below stated in its opinion that Congress did not intend that a taxpayer on the cash basis reporting his entire profit not actually received could not have the tax later computed on the installment basis (R. 7). The court below also stated in its opinion that the basis on which the respondent reported the transaction in his 1929 return did not clearly reflect his income (R. 8).

The petitioner contends that the taxpayer elected to report all of the profit from the deferred payment sale of the stock in the year of the sale rather than on the installment basis; that the filing of his income tax return constituted the taxpayer's binding election and prevents a recomputation of the tax for the year of the sale on the installment basis;

and that to permit such a recomputation generally would impose an unjustified burden on the administration of the revenues.

The question discussed here is discussed also in the Government's brief in *Pacific National Company* v. *Welch,* No. 528, present Term, to be argued immediately before this case.

In cases involving the question whether the method of accounting reflects income, "It is not the province of the court to weigh and determine the relative merits of systems of accounting". *Brown* v. *Helvering,* 291 U. S. 193, 204–205. If it is found that the "method of accounting" employed by the taxpayer clearly reflects the income, the requirement that returns be made in accordance with such method is binding upon the taxpayer [4] and the Commissioner [5] alike. Correction of certain items of income does not amount to a rejection of such method. *United States* v. *American Can Co., supra,* p. 419.

Section 42 of the 1928 Act provides that the amount of all items of gross income "shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period".

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[4] *United States* v. *Anderson*, 269 U. S. 422; *United States* v. *Mitchell*, 271 U. S. 9; *Brown* v. *Helvering*, 291 U. S. 193.

[5] *American National Co.* v. *United States*, 274 U. S. 99.

Section 111 (a) provides that the gain from the sale of property shall be the excess of the "amount realized" over the basis provided in Section 113. Section 111 (c) provides that the amount realized shall be the sum of any money received plus the fair market value of the property (other than money) received. Treasury Regulations 74, Articles 354 and 561, provide for the exceptional case in which the property or obligations of the purchaser of property have no fair market value. Cf. *Burnet* v. *Logan*, 283 U. S. 404.

These provisions of the statute and regulations provide a complete and accurate method for determination of the gain or loss on the sale of property. Congress also provided an alternative method of reporting income on the installment basis in some cases. Section 111 (e) provides that nothing in Section 111 shall prevent the use of the installment method in reporting income from installment sales.

Section 44 (a) of the 1928 Act provides that a person who regularly sells or otherwise disposes of personal property on the installment plan *may*, under regulations prescribed by the Commissioner with the approval of the Secretary, "return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price". Subsection (b) of that section provides that in the case of a casual sale or

other disposition of personal property for a price exceeding $1,000, if the initial payments do not exceed 40 per centum of the selling price, "the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section".

Section 44 of the Act obviously provides an alternative method, available at the election of the taxpayer, of reporting the profit derived from certain sales of property.

No provision corresponding to Section 44 of the 1928 Act was included in any of the revenue acts prior to the Revenue Act of 1926. For several years prior to 1926, however, the Commissioner of Internal Revenue had included provisions of the same general import in his regulations.[6] These provisions were likewise optional in their terms. Certain decisions of the Board of Tax Appeals[7] promulgated in 1925 cast considerable doubt upon the validity of these regulations, with the result that Congress included Section 212 (d) in the Revenue Act of 1926, which was made retroactive by Section 1208 of the Act to taxes imposed under prior

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[6] See Article 117 of Treasury Regulations 33 (Revised) prescribed under the Revenue Act of 1917, and Articles 42, 44, and 45 of Treasury Regulations 45, 62, and 65, prescribed under the Revenue Acts of 1918, 1921, and 1924, respectively.

[7] *Manomet Cranberry Co.* v. *Commissioner*, 1 B. T. A. 706; *B. B. Todd, Inc.*, v. *Commissioner*, 1 B. T. A. 762; *Six Hundred and Fifty West End Ave. Co.* v. *Commissioner*, 2 B. T. A. 958.

acts.[8] This method of reporting profit upon the limited class of sales specified was not *required* by the Act as necessary to clearly reflect the income. It was *permitted*, at the option of the taxpayer, in order to alleviate hardship where application of either the cash receipts and disbursements method or an accrual method of accounting often required payment of the total tax in a single year upon the ascertained profit. *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 413. That an election of the method of reporting profit from installment sales was contemplated by the statute is further emphasized by the fact that subsection (c) of Section 44 provides that if a taxpayer *elects* to report income on the installment basis, amounts received in the taxable year on sales made in prior years shall not be excluded.

B. THE REPORTING OF PROFIT FROM AN INSTALLMENT SALE OF PROPERTY ON EITHER METHOD PERMITTED BY THE STATUTE AND REGULATIONS CONSTITUTES A BINDING ELECTION

The respondent reported in his 1929 return the full amount of the difference between the cost of the property to him and the net sale price. Consistently, he did not report any part of the $22,500 received in monthly installment payments in 1930 in his return for 1930 (R. 5). It was in his refund claim filed on March 12, 1932, that the respondent

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[8] See S. Rep. No. 52, 69th Cong., 1st Sess., p. 19; H. Rep. No. 356, 69th Cong., 1st Sess., pp. 32–33; *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406.

requested computation of his 1929 income on the installment basis (R. 6).

By reporting his entire gain from the sale of personal property as income for the year of sale the respondent elected to have his gain taxed on that basis rather than in accordance with Section 44 (b) of the Act, and that election is binding, both upon him and the Commissioner of Internal Revenue. *Commissioner* v. *Moore*, 48 F. (2d) 526 (C. C. A. 10th), certiorari denied, 284 U. S. 620, and *Commissioner* v. *Garber*, 50 F. (2d) 588 (C. C. A. 9th), involving the same transaction; *Roy* v. *Commissioner*, 69 F. (2d) 786 (C. C. A. 5th), certiorari denied, 293 U. S. 580; *Howbert* v. *Norris*, 72 F. (2d) 753 (C. C. A. 10th); *Livermore* v. *Miller* (C. C. A. 5th), decided January 26, 1938, not yet officially reported but published in 1938 Prentice-Hall Federal Tax Service, Vol. 1, paragraph 5.177; *Marks* v. *United States*, 18 F. Supp. 911 (S. D. N. Y.); *Strauss* v. *Commissioner*, 33 B. T. A. 855, affirmed, *per curiam*, 87 F. (2d) 1018 (C. C. A. 2d); *Viault* v. *Commissioner*, 36 B. T. A. 430; *Briarly* v. *Commissioner*, 29 B. T. A. 256; *Louis Werner Saw Mill Co.* v. *Commissioner*, 26 B. T. A. 141; *Liberty Realty Corp.* v. *Commissioner*, 26 B. T. A. 1119; *Morgan Rundel* v. *Commissioner*, 21 B. T. A. 1019; *Johnson Realty Trust* v. *Commissioner*, 21 B. T. A. 1333; *Gilbert W. Lee* v. *Commissioner*, 6 B. T. A. 135, affirmed, *per curiam*, 41 F. (2d) 1004 (C. C. A. 6th).

In *Gilbert W. Lee* v. *Commissioner, supra,* the taxpayer had made his returns upon the installment basis, and, in refusing to permit him to change to the cash receipts and disbursements basis, the Board said (p. 138):

> Having once made his election, the petitioner should not be allowed to change to a different basis merely because subsequent legislation or other events made it to his interest so to do. * * *

In *Morgan Rundel* v. *Commissioner, supra,* the Board stated (p. 1020):

> Subsequent events or a change of mind now make petitioner's choice of the installment basis not to his liking, and so he seeks another method which it is claimed will produce a lower tax.
>
> It has been held, however, in a number of cases that the filing of a return of income according to one of two alternative methods recognized by statute constitutes a binding election and the taxpayer may not thereafter report on another basis. * * *

The right to elect between two or more methods of making returns or of reporting income is recognized in other sections of the revenue acts. Section 51 of the Revenue Act of 1928 grants to married individuals the privilege of filing a single joint return, in lieu of separate returns, and the choice, by filing the return, constitutes a binding election. *Buttolph* v. *Commissioner,* 29 F. (2d) 695 (C. C. A. 7th); *Rose* v. *Grant,* 39 F. (2d) 340 (C. C. A. 5th);

Morris v. *Commissioner*, 40 F. (2d) 504 (C. C. A. 2d); *Anderson* v. *United States*, 48 F. (2d) 201 (C. C. A. 5th); *United States* v. *Pettigrew*, 81 F. (2d) 666 (C. C. A. 9th); *O'Rourke* v. *Commissioner*, 81 F. (2d) 668 (C. C. A. 9th). Cf. *McIntosh* v. *Wilkinson*, 36 F. (2d) 807 (E. D. Wis.).

Sections 141 and 142 of the 1928 Act grant to an affiliated group of corporations the privilege of filing a consolidated return in lieu of the separate returns required by Section 52 of the Act, and the exercise of that privilege, evidenced by making either kind of return, is binding when made. *Alameda Inv. Co.* v. *McLaughlin*, 33 F. (2d) 120 (C. C. A. 9th); *Lucas* v. *St. Louis National Baseball Club*, 42 F. (2d) 984 (C. C. A. 8th), certiorari denied, 282 U. S. 883; *Radiant Glass Co.* v. *Burnet*, 54 F. (2d) 718 (App. D. C.); *Dr. Pepper Bottling Co.* v. *Commissioner*, 69 F. (2d) 768 (C. C. A. 5th); *Safety Electric Products Co.* v. *Helvering*, 70 F. (2d) 439 (C. C. A. 9th).

An election to report income from long-term contracts on the completed contract basis permitted by the Commissioner's regulations is binding upon the taxpayer. *Bent* v. *Commissioner*, 56 F. (2d) 99 (C. C. A. 9th); *Rice, Barton & Fales* v. *Commissioner*, 41 F. (2d) 339 (C. C. A. 1st); *Ellis* v. *Commissioner*, 16 B. T. A. 1225; *R. G. Bent Co.* v. *Commissioner*, 26 B. T. A. 1369; *Hammond* v. *Commissioner*, 36 B. T. A. 497. Other permissible methods of reporting income which have been held to consti-

tute a binding election when adopted are illustrated by the cases of *Ramsey* v. *Commissioner*, 66 F. (2d) 316 (C. C. A. 10th), certiorari denied, 290 U. S. 673; *Moran* v. *Commissioner*, 67 F. (2d) 601 (C. C. A. 1st); *Momsen-Dunnegan-Ryan Co.* v. *Helvering*, 68 F. (2d) 754 (App. D. C.); *LeBolt & Co.* v. *United States*, 67 C. Cls. 422; *Russell-Miller Milling Co.* v. *Helvering*, 69 F. (2d) 392 (App. D. C.).

Similarly, the failure to choose the capital net gain rate of tax in a return "at the election of the taxpayer" under Section 101 of the 1928 Act is binding. *United States* v. *The National City Bank of New York* (S. D. N. Y.) reported in 1937 Prentice-Hall, paragraph 1517. But even if such a choice were not a binding election, since it merely involves choice of the rate of tax, the election not to use the installment basis is a binding election, because it involves the entire method of reporting income from installment sales and if not a binding election administration of the revenues will be impeded because readjustment of the income for the year of sale will require readjustment of the income for all subsequent years in which installment payments are made on the sale contract.

Moreover, the respondent, for a nominal consideration, assigned the sales contract, dated April 11, 1929, to his wife before August 12, 1931 (R. 5). Even if the respondent were permitted to use the installment basis, Section 44 (d) of the 1928 Act would apply and the respondent would be required to report the entire gain from the contract in the

year in which he made this disposition of it. The burden is on the respondent in this refund action to show that he overpaid the tax in 1929. He has not shown that the assignment was not made in 1929. If it was, the complete gain was taxable in that year.

The court below does not cite the numerous cases discussed above holding that the income tax return constitutes a binding election of a method of reporting installment sales. The cases cited by the court (R. 7) are distinguishable. The only two cases cited by the court below (*Davis* v. *United States*, 71 C. Cls. 444, 46 F. (2d) 377; *Schneider, Trustee* v. *Lucas*, 15 Am. Fed. Tax Rep. (W. D. Ky.) not officially reported, reversed 47 F. (2d) 1006 (C. C. A. 6th), certiorari denied, 284 U. S. 622) are distinguishable.

The opinion in the *Davis* case did not discuss election but found as a fact that the sales transactions in 1919 and 1920, which the taxpayer had treated in its return as one transaction creating a profit in 1920, were two transactions. The court held that this mistake of fact could be corrected by the taxpayer and then one of the sales could be reported on the installment basis. There had been no election as to that sale. In the present case there was only one sale in the tax year of 1929 and the respondent did elect to report that sale as a deferred payment sale not on the installment plan.

In the *Schneider* case election was not discussed by the courts. The bankrupt taxpayer had re-

ported the entire profit from a sale of real estate in 1925 for cash and the assumption of mortgages payable in later years. The trustee sought to have the income computed on the installment basis. The district court held that the contract price included the assumed mortgages but that profit was realized only as the mortgages were paid and, therefore, the installment method was applicable because initial payments were less than 25 percent of the sale price. The Sixth Circuit Court of Appeals held that the installment method was not applicable because the initial payments, including the mortgages to the extent that they exceeded the vendor's basis, were more than 25 percent of the sale price. Both courts seemed to assume that the installment basis was available to the taxpayer if the terms of the statute applied. Election between two applicable methods was not considered.

The principle of election, as established by the decisions discussed above, is based upon a choice of *method* afforded taxpayers by the statute or the regulations, and the necessity, in order to promote orderly administration in the assessment, collection, and refund of taxes, of requiring both the taxpayer and the Commissioner to abide by that choice when once made.[9]

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[9] Cf. *Lucas* v. *Sterling Oil & Gas Co.*, 62 F. (2d) 951 (C. C. A. 6th), where the taxpayer was not bound by a choice of method permitted by the regulations but made without sufficient knowledge of material facts and corrected by filing an amended return prior to filing the return for the succeeding year.

The taxpayer's election as to the method of reporting income is made when the return is filed. *Pathe Exchange* v. *Commissioner,* 77 F. (2d) 306 (C. C. A. 2d, Swan, J.); cf. *Bent* v. *Commissioner,* 56 F. (2d) 99 (C. C. A. 9th).

Clearly, we submit, the principle of election as established in the numerous cases cited above must be observed in order to avoid confusion in the administration of the tax laws. Whether income will thereby escape taxation, or the taxpayer in individual cases pay more tax because of his election, is not of controlling importance unless principles of estoppel are involved.

C. ANY OVERSTATEMENT OF INCOME FOR YEAR OF SALE MUST BE CORRECTED IN ACCORDANCE WITH METHOD EMPLOYED RATHER THAN BY CHANGE OF METHOD

The Court of Claims based its decision, in part at least, upon the conclusion that "the basis on which plaintiff reported the transaction in his return for 1929 * * * did not clearly reflect plaintiff's income." (R. 8.) In this the court was in error for several reasons.

In the first place, as already demonstrated, a taxpayer is required to make his return in accordance with the method of accounting employed—in this case the cash receipts and disbursements method—subject only to the condition that such method clearly reflects the income. The right to report the profit "realized or to be realized" upon certain deferred-payment sales in accordance with the pro-

visions of Section 44 of the Act is a privilege granted by the statute, available at the election of the taxpayer, and is not a requirement that must be complied with in order to clearly reflect the income.

In the second place, it is not shown that the respondent's return for 1929 did not clearly reflect the income for that year. The court's conclusion that respondent's 1929 return did not clearly reflect his income for that year is based entirely upon the fact that in 1932 "the contract of sale of the stock in question was changed and the then unpaid purchase price thereof was reduced to $75,000." (R. 8.) It does not follow, however, that because the amount of the unpaid purchase price was reduced in a subsequent year the income for the year of the sale was overstated. Section 111 (a) of the Revenue Act of 1928 provides, with certain exceptions not material here, that "the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113 * * *." The basis in the instant case is the cost of $46,000. Section 111 (c) defines the "amount realized" from the sale or other disposition of property as "the sum of any money received plus the fair market value of the property (other than money) received."

The terms of the 1929 contract are not disclosed in detail, but the findings disclose that it provided for a down payment of $25,000 and the payment of the balance of $225,000 in monthly installments of

$1,875 beginning October 1, 1929, together with interest. If the right to receive these future payments had a fair market value at the time of the sale equal to the amount of the unpaid balance of the purchase price there was no overstatement of income for 1929.[10] *Marr* v. *United States,* 268 U. S. 536; *Whitlow* v. *Commissioner,* 82 F. (2d) 569 (C. C. A. 8th); *Commissioner* v. *Moir,* 45 F. (2d) 356 (C. C. A. 7th).

In the third place, if respondent's income for 1929 was erroneously overstated his remedy was to

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[10] Sales of this character are usually either in the form of agreements of purchase and sale which contemplate that a transfer of title will not be made until all or a substantial portion of the purchase price has been paid, or sales in which there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments. See Articles 351 and 352 of Treasury Regulations 74. But for the purpose of computing the taxable gain to be reported in the year of sale, where gain is realized in that year, no distinction is made between cases where the transfer of title is deferred until payment of the purchase price is received and cases where title is transferred subject to a lien. Cf. *Burnet* v. *Logan*, 283 U. S. 404; *Wells Amusement Co.* v. *Commissioner*, 70 F. (2d) 208 (C. C. A. 4th); *Stiles* v. *Commissioner*, 69 F. (2d) 951 (C. C. A. 5th); *Ives Dairy* v. *Commissioner*, 65 F. (2d) 135 (C. C. A. 5th); *Trust No. 5522, Etc., Security-First Nat. Bank* v. *Commissioner*, 27 B. T. A. 1250, reversed on another point, 83 F. (2d) 801 (C. C. A. 9th); *Titus* v. *Commissioner*, 33 B. T. A. 928, petition for review dismissed, 88 F. (2d) 1007 (C. C. A. 10th); *Doric Apartment Co.* v. *Commissioner*, 32 B. T. A. 1187; *Lloyd* v. *Commissioner*, 33 B. T. A. 903; *Cambria Development Co.* v. *Commissioner*, 34 B. T. A. 1155; *Greenwood* v. *Commissioner*, 34 B. T. A. 1209; *Hobbs* v. *Commissioner*, 26 B. T. A. 241; *Rapid Transit Land Sales Co.* v. *Commissioner*, 20 B. T. A. 608; *Woodmar Realty Co.* v. *Commissioner*, 17 B. T. A. 88.

have it corrected, by a proper refund claim, in accordance with the method of reporting gain which was chosen in making his return, rather than to have his gross income redetermined in accordance with the alternative method which he might have chosen originally.

As already stated, it is not shown that the cash receipts and disbursements "method of accounting" employed by the respondent would not clearly reflect his income if properly applied. Adjustments to income may be made in accordance with the "method" employed in order to clearly reflect the income. *United States* v. *American Can Co., supra.* Such adjustment could have been made by subsequent claim if it later developed that the initial statement was based upon erroneous facts. *Continental Tie & L. Co.* v. *United States,* 282 U. S. 290, 295; *Williams* v. *Commissioner,* 45 F. (2d) 61 (C. C. A. 5th). If the value assigned to the right to receive the deferred payments was overstated that error could be corrected.[11] On the other hand, if the right to receive future payments had no value, or if, as this Court found in *Burnet* v. *Logan,* 283 U. S. 404, 413, the promise to make

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[11] *Wells Amusement Co.* v. *Commissioner*, 70 F. (2d) 208 (C. C. A. 4th); *Stiles* v. *Commissioner*, 69 F. (2d) 951 (C. C. A. 5th); *Ives Dairy* v. *Commissioner*, 65 F. (2d) 135 (C. C. A. 5th); *Trust No. 5522, Etc., Security-First Nat. Bank* v. *Commissioner*, 27 B. T. A. 1250, reversed on another point, 83 F. (2d) 801 (C. C. A. 9th); *Doric Apartment Co.* v. *Commissioner*, 32 B. T. A. 1187; *Rapid Transit Land Sales Co.* v. *Commissioner*, 20 B. T. A. 608.

future payments was "wholly contingent upon facts and circumstances not possible to foretell with anything like fair certainty" no amount would be includible in gross income on account of the contract for future payments.[12] Any adjustments to income made necessary by the reduction in the amount of the unpaid payments in 1932 should be reflected in the return of that or some subsequent year after the 1929 income is properly determined in accordance with the return. This reduction in the net sales price does not require or justify computation of 1929 income on a basis different from that chosen when the return was filed.

D. A GENERAL RULE WHICH WOULD PERMIT SUBSEQUENT CHANGE OF POSITION AND USE OF ALTERNATIVE METHOD OF REPORTING GAIN FOR THE YEAR OF SALE WOULD IMPEDE ADMINISTRATION OF THE REVENUES

The Government's position is based upon the doctrine of election and not upon estoppel.

The installment sales provisions do not propose a requirement which is essential in order clearly to reflect the income. They contemplate a consistent treatment of proceeds from deferred-payment sales which extend over a period of years. Such consistency can be insured only by requiring the tax-

[12] *Titus* v. *Commissioner*, 33 B. T. A. 928, petition for review dismissed, 88 F. (2d) 1007 (C. C. A. 10th); *Lloyd* v. *Commissioner*, 33 B. T. A. 903; *Cambria Development Co.* v. *Commissioner*, 34 B. T. A. 1155; *Greenwood* v. *Commissioner*, 34 B. T. A. 1209; *Woodmar Realty Co.* v. *Commissioner*, 17 B. T. A. 88; *Graves* v. *Commissioner*, 17 B. T. A. 1318.

payer to abide by his original choice of method for reporting such gains. If, after the lapse of a period of time, the taxpayer is permitted to have his income for the year of the sale redetermined by the use of the alternative method consistency in the treatment of installment sales could be insured only by permitting or requiring the Commissioner of Internal Revenue to redetermine the correct income for all years subsequent to the year of the sale in which payments are received. This procedure obviously would entail a great administrative burden.

The principle of election as applied in this and other situations, while sometimes resulting in a larger tax to the individual taxpayer or a loss of revenue to the Government, is fair and useful. It should be sustained in the instant case.

CONCLUSION

The decision of the court below is wrong and should be reversed.

Respectfully submitted.

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FEBRUARY, 1938.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

NET INCOME OF INDIVIDUALS DEFINED

SEC. 212. (d) Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price. In the case (1) of a casual sale or other casual disposition of personal property for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this subdivision. As used in this subdivision the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

INSTALLMENT SALES

SEC. 1208. The provisions of subdivision (d) of section 212 shall be retroactively applied in computing income under the pro-

visions of the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or the Revenue Act of 924, or any of such Acts as amended. Any tax that has been paid under such Acts prior to the enactment of this Act, if in excess of the tax imposed by such Acts as retroactively modified by this section, shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded to the taxpayer as provided in section 284.

Revenue Act of 1928, c. 852, 45 Stat. 791:

PART II. COMPUTATION OF NET INCOME

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

(e) *Determination of gain or loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

* * * * *

PART IV. ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or

credits should be taken as of a different period.

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in personal property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of realty and casual sales of personalty.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(c) *Change from accrual to installment basis.*—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the

year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

* * * * *

PART V. RETURNS AND PAYMENT OF TAX

SEC. 51. INDIVIDUAL RETURNS

(a) *Requirement.*—The following individuals shall each make under oath a return stating specifically the items of his gross income and the deductions and credits allowed under this title—

(1) Every individual having a net income for the taxable year of $1,500 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of $3,500 or over, if married and living with husband or wife; and

(3) Every individual having a gross income for the taxable year of $5,000 or over, regardless of the amount of his net income.

(b) *Husband and wife.*—If a husband and wife living together have an aggregate net income for the taxable year of $3,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

* * * * *

SUPPLEMENT B. COMPUTATION OF NET INCOME

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title shall be determined under the provisions of section 112.

(e) *Installment sales.*—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

*   *   *   *   *

Treasury Regulations 74:

ART. 321. *Computation of net income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in which the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the tapayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 331–333.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 322. *Bases of computation.*—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. * * *.

ART. 331. *When included in gross income.*—Gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. * * *

ART. 351. *Sale of personal property on installment plan.*—

* * * * *

In the case of a casual sale or other casual disposition of personal property other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, for a price exceeding $1,000, income may be returned on the installment basis provided the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale or other disposition

is made do not exceed 40 per cent of the selling price.

If for any reason the purchaser defaults in any of his payments, and the vendor returning income on the installment basis repossesses the property, the entire amount received in installment payments and retained by the vendor, less the sum of the profits previously returned as income and an amount representing proper allowance for damage and use, if any, will be income of the vendor for the year in which the property is repossessed, and the property repossessed must be carried on the books of the vendor at its original cost, less proper allowance for damage and use, if any.

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible.

If an installment obligation is satisfied, or otherwise disposed of, gain or loss may result therefrom and must be determined in accordance with section 44 (d) and article 355.

ART. 355. *Gain or loss upon disposition of installment obligations.*—If an installment obligation is satisfied at other than its face value or is sold or exchanged, gain or loss results to the extent of the difference between (1) the excess of the face value of the obligation over the amount of income which would be returnable were the obligation satisfied in full and (2) the amount realized upon such disposition.

If an installment obligation is distributed, transmitted, or disposed of otherwise than by sale or exchange, gain or loss results to

the extent of the difference between (1) the excess of the face value of the obligation over the amount of income which would be returnable were the obligation satisfied in full and (2) the fair market value of the obligation at the time of such distribution, transmission, or disposition.

The entire amount of gain or loss resulting from the disposition or satisfaction of installment obligations shall be recognized except as provided in section 112 and articles 571–580.

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